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In the Supreme Court of the United States

OCTOBER TERM, [redacted] 1925

JAMES C. DAVIS, DIRECTOR GENERAL AND AGENT (GRAND RAPIDS & INDIANA), PETITIONER

v.

THE MICHIGAN TRUST COMPANY, RECEIVER OF RATHBONE MANUFACTURING COMPANY, RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

By A. A. McLAUGHLIN,
GEORGE M. CLAPPERTON,
CHARLES M. OWEN,
Counsel for Petitioner.

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1925

In the Supreme Court of the United States

JAMES C. DAVIS, DIRECTOR GENERAL, Agent, United States Railroad Administration (Grand Rapids & Indiana Railroad), petition, *v.* THE MICHIGAN TRUST COMPANY, Receiver of Rathbone Manufacturing Company, respondent.	No. 897

To the Honorable Supreme Court of the United States:

The petition of James C. Davis, Director General, Agent, United States Railroad Administration (Grand Rapids & Indiana Railroad), respectfully shows unto this Honorable Court:

I

That on the 6th day of December, 1919, the White Sewing Machine Company, a corporation under the laws of the State of Ohio, and William G. Renwick, of Chicago, Illinois, filed in the District Court of the United States for the Western District of Michigan, Southern Division, a bill in equity, asking for the appointment of a receiver of the Rathbone Manufacturing Company, a corporation under the laws of the State of Michigan. The bill

alleged generally that the defendant had borrowed from banks and from others over One hundred thousand dollars ($100,000) in order to pay its debts and losses in operation; that most of the commercial paper representing money borrowed had been endorsed by A. D. Rathbone, a stockholder; that the said A. D. Rathbone had refused to make further endorsements without which it was impossible for defendant to borrow further sums to pay its debts; that it had only about one hundred dollars ($100) cash on hand, was without credit and unable to pay its debts in the ordinary course of business; that there were practically no quick assets and that it was unable to collect its accounts receivable; that it indebtedness was one hundred forty thousand dollars ($140,000), a large portion of which was then due and that it had no money or means of raising money to pay such indebtedness. It was further alleged on information and belief, that as a going concern the value of defendant's assets exceeded the amount of its liabilities and that a stoppage of business would result in great depreciation of assets and make it impossible for defendant to pay its debts; that creditors were demanding payment; that judgments had been taken amounting to five thousand dollars ($5,000) and other suits commenced aggregating five thousand dollars ($5,000); that defendant was threatened with executions which would result in ruining the business and would almost certainly result in the insolvency of defendant and great loss to creditors.

It was further alleged that plaintiffs believed from information received, that if the assets of the corporation were properly handled and conserved by a receiver, creditors could probably be paid in full, and that there was a possibility that there might be a surplus for stockholders, but that otherwise there would be great loss to creditors; that the business was then being operated at a small profit and that in the opinion of plaintiff it might be profitably operated, but that suspension of operations and the breaking up of the business would result in great sacrifice of assets. The complainants prayed for an accounting between defendant corporation and its creditors, that the assets be marshaled and for a determination of creditors to be paid, and for the appointment of a receiver, and that the assets of defendants and the rights of creditors be ascertained, and the court fully administer the funds and property and enforce the rights of the creditors.

The answer of the defendant corporation was filed simultaneously with the complaint, admitted the allegations of the bill and consented to the appointment of a receiver. At the same time an order was made by the District Court appointing the respondent herein, the Michigan Trust Company, receiver of the defendant Company, and of all its property and assets, divesting the receiver with all the property and assets of defendant, with full power and authority to take into its possession all the property and assets of every kind and descrip-

tion belonging to the defendant, to collect the profits and revenues of all such property accruing to defandant, to institute lawsuits for the recovery of any damages or demands, to prosecute and defend any suits pending, to compound and settle with any debtor or creditor or persons responsible in any way for its property as the receiver should deem just and beneficial, and to sell, convey, and assign any and all of the property of the defendant subject to the supervision of the court, and in general vesting receiver with the usual rights and powers of receivers in such cases.

II

The total amount of ordinary claims of indebtedness allowed was actually two hundred and twenty-one thousand, two hundred and twenty-six dollars and sixty-one cents ($221,226.61), instead of one hundred and forty thousand dollars ($140,000) as was alleged in the bill of complaint. At the time of the filing of the petition for appointment of a receiver the Rathbone Manufacturing Company was, in fact, insolvent in that the aggregate of its property and assets was not at a fair valuation, sufficient in amount to pay its debts.

III

On the 15th day of May, 1920, the Director General of Railroads, United States Railroad Administration for the Grand Rapids & Indiana Railroad, filed proof of claim, which is the subject

of litigation in the present cause, which was composed of items of freight demurrage and switching charges on shipments of merchandise for the said Rathbone Manufacturing Company, amounting in the aggregate to the sum of three thousand nine hundred and fifty-three dollars and forty-six cents ($3,953.46), and also for the conversion of pig iron of the value of five hundred and twenty-seven dollars and seventy-four cents ($527.74), with interest on said items. The proof of claim was duly filed as a preferred claim under Article 3466 of the Revised Statutes of the United States. The portion of the said statute pertinent reads as follows:

> Whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall first be satisfied and the priority here established shall extend as well to cases in which a debtor not having sufficient property to pay all his debts makes a voluntary assignment thereof * * * as to cases in which an act of bankruptcy is committed.

This claim was duly allowed and given priority by the Master in Chancery, John S. Lawrence, who was later succeeded by Kirk E. Wicks as Master in Chancery.

IV

On April 18th, 1923, the receiver, respondent herein, Michigan Trust Company, filed objections to the allowance of the said claim as a preferred claim, objecting that the said claim should have

been allowed as an ordinary claim, not entitled to preference. On May 17th, 1923, the Master in Chancery filed a report in which the allowance of the claim as a preferred claim was set aside and the claim allowed as an ordinary claim for four thousand five hundred and twenty-two dollars and ninety-five cents ($4.522.95).

V

Petitioner herein, James C. Davis, Director General United States Railroad Administration, the claimant, on June 4th 1923, filed exceptions to the report of the Master for the reason that the Master in Chancery had held in his opinion that the claim was not entitled to priority, notwithstanding the fact that it was a claim due to the United States Government. The petitioner based its right to preference on the entire claim on the said Section 3466 of the Revised Statutes of the United States. The exceptions stated in substance that the report of the Master in Chancery was in error in its allowance of this claim as a preferred claim under the authority of the said priority statute, and stated that the allegations of the bill of complaint asking for a receiver for the Rathbone Manufacturing Company established insolvency within the meaning of the said Section 3466, Revised Statutes, thus establishing priority to the claim of the United States Government. The exceptions further stated that the allegations of this bill of complaint were admitted by the answer of the Rathbone

Manufacturing Company and that the record of the receivership with the District Court disclosed that the Rathbone Manufacturing Company was, in fact, insolvent both at the time of the filing of the bill of complaint and at the date of the filing of the Master's report and alleged that the report of the Master disallowing the said claim as a priority claim should be set aside, and an order entered, allowing the claim of the Director General entitled to priority. The said exceptions prayed that the District Court should fix a time for hearing its exceptions and for a review of the Master's recommendation; and also for an order allowing the claimant the entire amount of its claim as one entitled to priority because it was due to the United States Government.

VI

The cause was duly heard on the exceptions of the Director General of United States Railroad Administration, and on September 15th, 1923, the following decree was entered:

> This cause having come on to be heard upon the exceptions of James C. Davis, Director General, Agent, United States Railroad Administration (Grand Rapids & Indiana Railroad), to the report of the Master in Chancery relating to the claim of said James C. Davis, Director General, Agent; after argument thereof, and upon due consideration thereof, it is Ordered, that the exceptions of said claimant be and are

hereby overruled and that the report of the Master in Chancery be and is hereby confirmed: and that claimant be and is hereby allowed the benefit of an exception to this order. Dated September 13, 1923.

C. W. SESSIONS,
United States District Judge.

VII

That thereafter, to wit, on the 15th day of October, 1923, an appeal was allowed and perfected, and on the 15th day of February, 1924, a transcript of all the proceedings was filed in the United States Circuit Court of Appeals, Sixth Circuit, sitting at Cincinnati, and said cause was docketed in said Court of Appeals, entitled,

James C. Davis, Director General, Agent, United States Railroad Administration (Grand Rapids & Indiana Railroad), appellant v. The Michigan Trust Company, Receiver of Rathbone Manufacturing Company, appellee,

and numbered 4028 on said docket.

VIII

That the assignment of errors filed in said cause was as follows:

ASSIGNMENTS OF ERROR

1

That the claim of said James C. Davis, Director General, was, and is a preferred claim within the

meaning of Section 3466 of the Revised Statutes of the United States and should be allowed as a preferred claim, with priority as to payment over the ordinary claims filed against said Estate.

2

That said claim of said James C. Davis, Director General, is a preferred claim within the meaning of said Section 3466 of the Revised Statutes of the United States for the reason that at the time of the filing of the bill of complaint in said suit of the White Sewing Machine Company versus the Rathbone Manufacturing Company, said Rathbone Manufacturing Company was insolvent and has committed an act of bankruptcy within the meaning of said Section 3466 in that because of insolvency a receiver was put in charge of the said Rathbone Manufacturing Company.

3

That at the time of the filing of the bill of complaint the said Rathbone Manufacturing Company was insolvent and committed an act of bankruptcy within the meaning of the said Section 3466, U. S. Revised Laws in that being insolvent, it applied for a Receiver for its property.

That appellant asserted priority for $527.74 of the claim filed for the reason that the merchandise therein referred to was converted by the Rathbone Mfg. Co., and that this claim of preference was not passed upon by the Master, although appellant is entitled to preference because of the fraudulent and

unlawful acts of the Rathbone Manufacturing Company in converting to its use this property within its custody.

IX

That afterwards, to-wit, on the 9th day of October, 1924, the case came on to be heard before the Honorable Judge Denison, the Honorable Judge Mack and the Honorable Judge Sater in the Circuit Court of Appeals, and on the 11th day of November, 1924, a decree was entered in said cause by the Circuit Court of Appeals of the Sixth Circuit, affirming the said order of the District Court of the United States for the Western District of Michigan, Southern Division.

X

The questions and propositions of law involved in this case are substantially as follows:

Assuming that the Rathbone Manufacturing Company was actually insolvent at the time of the filing of the bill of complaint asking for a receiver, and at all times thereafter, in that its assets at a fair valuation were insufficient to pay its debts:

1. Is a claim of Director General, United States Railroad Administration, as a United States claim, entitled to priority over other claims against the receivership under Section 3466, Revised Statutes of the United States, on the ground that the said Rathbone Manufacturing Company by assenting and practically joining in the prayer for a receiver

made a general assignment for the benefit of creditors in a sense satisfying the said R. S. Section 3466?

2. Is an act of bankruptcy performed according to the provisions of said Section 3466 when a receiver is put in charge of the property of an insolvent corporation because the said corporation is unable to pay its debts in the ordinary course of business, though the bill asking for a receiver does not allege actual total insolvency?

3. The last clause of Section 3A (4) of the Bankruptcy Act gives as an act of bankruptcy, "because of insolvency a receiver or trustee has been put in charge of his property under the laws of a state." Has an act of bankruptcy under this section been committed, although the bill asking for a receiver alleges merely an inability on the part of the debtor to pay its debts in the ordinary course of business, but does not allege in so many words that the debtor is actually insolvent, when the fact is that the debtor is actually insolvent?

4. Does Section 10 of the Federal Control Act (40 Stat., Mar. 21, 1918, c. 25) prevent the Director General from asserting government priority over other claims on claims arising out of the Governmental War operations of the railroads?

XI

There is a conflict of authority on all of these questions and petitioner is advised that the Supreme Court has never passed on these questions.

It is the contention of the petitioner that at the time that Section 3466 of the U. S. Revised Statutes was first enacted there was no bankruptcy act and that the cases interpreting that section have defined an act of bankruptcy to be performed when a debtor who is actually insolvent by some legal proceeding turns his property over in its entirety to other funds to be administered for the benefit of creditors.

The Circuit Court of Appeals of the Sixth Circuit puts the matter as follows, Vol. 2 Federal Reporter, 2nd Series, page 196:

> By the phrase of cases in which an act of bankruptcy is committed all in R. S. Section 3466, is the assertion of the government's claim of priority over other creditors limited, in addition to proceedings in which by action of the state through insolvency or analogous laws, a debtor is divested of his property for distribution of his property to those under a federal bankruptcy act, when such exists, or does it extend as well to equity proceedings wherein a receiver has been appointed in circumstances sufficient to make such appointment an act of bankruptcy, even though the creditor has availed himself thereof within the time limit—four months, by Section 3B of the Bankruptcy Act—to throw the debtor into actual bankruptcy under a petition wherein the appointment of such receiver is alleged as the, or one of the acts of bankruptcy, committed?

Again, there is conflict in the authorities.

The case of *Davis* v. *Pullen*, 277 F. 650 (C. C. A. 1), and *Davis* v. *Miller-Link Lumber Company*, 296 F. 649 (C. C. A. 5), holds squarely that the appointment of a receiver under the circumstances of the present case is an act of bankruptcy satisfying the priority act R. S. Section 3466.

The Circuit Court of Appeals in its decision cites the case of *Equitable Trust Company* v. *Conn. Brass Mfg. Co.*, 790 Fed. 712 (C. C. A. 2), as holding contrary, and in such split of authority follows the latter case. The court holds, in other words, that no priority can attach to a United States claim in an equity proceeding, at least unless the receiver has been put in charge of the insolvent's property, because of an allegation of actual insolvency. The court likewise expresses doubt as to whether in equity proceedings any United States claim other than claims for taxes would be accorded priority.

The other line of cases hold clearly that any debt due to the United States of whatever nature, is entitled to priority in an insolvent receivership.

XII

It is the claim of the petitioner that even under the Bankruptcy Act, under Section 3 A (4), that where a receiver has been put in charge of an insolvent's property under a bill of complaint alleging only inability to pay debts in the ordinary course of business, where the debtor is actually insolvent in

fact, an act of bankruptcy has been committed. This is the holding of the later line of cases discussed by the Circuit Court of Appeals in the present cause, Volume 2, Federal Reporter, second series page 196. The court also discusses an earlier line of cases opposing this holding and which deem it essential "that the appointment be based in whole or in part upon such insolvency" meaning that the bill asking for a receiver must allege actual insolvency.

The Circuit Court of Appeals found it unnecessary to decide this question although it is the claim of the petitioner that according to the later line of cases in the present cause, an act of bankruptcy under the Bankruptcy Act was committed, and hence that under R. S. Section 3466 the claim of the government is entitled to priority.

Although to the petitioner's best belief, it has prior to the decision of the circuit Court of Appeals in this cause been unanimously decided in a number of adjudicated cases that a claim of Director General of Railroads was a valid claim of the United States, hence entitled to priority like any other United States claim, yet the Circuit Court of Appeals held, and it is apparently the decisive point in the case that Section 10, Federal Control Act (40 Stat. March 1918, c. 25) prevents the Director General's claims from being in that class of government claims entitled to priority.

The decision of the Circuit Court in the present cause stands alone in so holding.

XIII

And your petitioner avers that the present case is one in which it is proper for this court to issue a writ of certiorari:

1. Because the Circuit Court of Appeals held that the claim of the petitioner is not entitled to priority under Section U. S. Revised Statutes 3466.

2. Because the questions of law involved herein have not been passed upon by this court.

3. Because the public interest and the interest of jurisprudence require a decision of this court upon the questions of law involved herein.

4. Because there is a conflict between the law as expounded by the Circuit Court of Appeals of the Sixth Circuit and other Circuit Courts.

XIV

Your petitioner is advised that said judgment of the Circuit Court of Appeals is final and is erroneous, and that this Honorable Court should require the case to be certified to it for its review and determination under the Act of Congress permitting causes made final in the Circuit Court of Appeals to be certified for revision.

Your petitioner further avers that on to wit, the 13th day of January, 1925, an appeal from the Circuit Court of Appeals, Sixth Circuit, to the United States Supreme Court was allowed, but your petitioner is now advised that the present cause is ancillary to the original suit in equity, White Sewing Machine Company vs. Rathbone Manufactur-

ing Company, supra, and inasmuch as the jurisdiction of the District Court in that case depended upon diversity of citizenship alone that the jurisdiction in the present cause would probably follow that, and hence the decree of the Circuit Court of Appeals in this cause would be final according to the provisions of Section 128 of the Judicial Code of the United States.

XV

Your petitioner further avers that certified copy of the transcript of the record in this cause was duly forwarded to the Supreme Court with the petition for the appeal aforesaid, and your petitioner herein prays that said certified transcript of record may be considered as a part of this application for writ of certiorari according to Rule 37 of the Supreme Court.

Wherefore your petitioner respectfully prays that a writ of certiorari be issued under the seal of the Court, directed to the United States Circuit Court of Appeals for the Sixth Circuit, sitting at Cincinnati, demanding the court to certify and send to this Court on a day to be designated, a full and complete transcript of the record and all proceedings of the Circuit Court of Appeals had in said cause to the end that this cause may be reviewed and determined by this Honorable Court as provided by the Act of Congress, approved March 3, 1891, establishing the Circuit Court of Appeals and defining and regulating its jurisdiction, and

that the said judgment of the Circuit Court of Appeals be reversed by this Honorable Court, and for such other and further relief as may seem proper.

And your petitioner will ever pray.

A. A. McLaughlin.
George Clapperton.
Charles M. Owen.

State of Michigan,
County of Kent, ss.

George Clapperton, being duly sworn, says that he is one of the attorneys and of counsel for James C. Davis, Director General, Agent, United States Railroad Administration (Grand Rapids & Indiana Railroad), and as such had personal charge for him of the case in the foregoing petition mentioned in the District Court of the United States for the Western District of Michigan, Southern Division, and in the United States Circuit Court of Appeals for the Sixth Circuit; that he has read the said petition by him subscribed; and that the facts therein stated are true to the best of his information and belief.

George Clapperton.

Sworn to and subscribed before me this 6th day of February, A. D. 1925.

Theoda S. Vincent,
Notary Public, Kent County, Michigan.

My commission expires 3–31–1925.

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